RELEVANT PROVISIONS INVOLVED

The Court of Appeals held that the United States Bankruptcy Code preempts California Code of Civil Procedure Section 1800. Cal. Civ. Proc. Code § 1800, in pertinent part, provides that:

> The assignee of any general assignment for the benefit of creditors . . . may recover any transfer of property of the assignor:
>
> (1) To or for the benefit of a creditor;
>
> (2) For or on account of an antecedent debt owed by the assignor before the transfer was made;
>
> (3) Made while the assignor was insolvent;
>
> (4) Made on or within 90 days before the date of the making of the assignment . . .; and
>
> (5) That enables the creditor to receive more than another creditor of the same class.

See Cal. Civ. Proc. Code § 1800(b).

STATEMENT OF THE CASE

A. Common Law Background

This case concerns a state statute that vests assignees for benefit of creditors with the power to set aside and recover otherwise lawful pre-assignment transfers that "prefer" certain of the assignor's creditors. Assignments for the benefit of creditors are venerable common law devices for liquidating corporate debtors. In such common law assignments, the debtor voluntarily transfers its assets to an assignee who is charged with the duty to liquidate the assets and distribute the proceeds to creditors. *See, generally*, Charles Jordan Tabb, *The Law of Bankruptcy* § 1.5 (1997); 1 *Chapter 11 Theory and Practice: A Guide to Reorganization, Nonbankruptcy Options: Assignments, Compositions and Receiverships* § 2:04 (James F. Queenan et al. eds., 1994). At common law a debtor's ability to make an assignment for the benefit of creditors was viewed as a "necessary incident" to the ownership of property that included the power to dispose of property "as one may see fit." 6 AM. JUR. 2d, *Assignments for the Benefit of Creditors* §§ 1, 66 (2004); *see also Pobreslo v. Joseph M. Boyd Co.*, 287 U.S. 518, 524, 526 (1933) (recognizing "the right to make a voluntary assignment for the benefit of creditors is a personal right inherent in the ownership of property, and existed at common law independent of statute" and that the "substantive rights" of the parties to the common law assignment derive from contract and trust law) (internal quotations omitted); *Brashear v. West*, 32 U.S. 608, 614 (1833) (stating that general assignments were recognized at common law without the necessity of any statutory authorization, as "[t]he right to make it results from the absolute ownership which every man claims over that which is his own"). Finally, at common law, the assignee stood in the place of the assignor and its rights were limited to those that the assignor could convey.

The power to avoid "preferences," in contrast, is grounded in statutory rather than common law. "A preference is a transfer that enables a creditor to receive payment of a greater percentage of his claim . . . than he would have received if the transfer had not been made and he had participated in the distribution of assets of the bankruptcy estate." H.R. Rep. No. 95-595, at 177 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6138; s*ee also* Thomas H. Jackson, *The Logic And Limits Of Bankruptcy Law* 124-125 (Beard Books 2001) (1986); Douglas G. Baird, *Elements Of Bankruptcy* 147 (3d ed. 2001) (defining preferences as "eve-of-bankruptcy transfers to creditors that distort bankruptcy's *pro rata* sharing rule"). At common law, a debtor had every right to pay one creditor in preference to another and disfavored creditors (and the debtor itself) simply had no claim against the favored creditor, provided the transfer was made to satisfy a genuine obligation owed by the debtor. *See, e.g., Grupo Mexicana de Desarrallo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 322 (1999) (ruling that a federal district court lacked authority to issue a prejudgment injunction restraining a transfer of a debtor's property to a bona fide creditor because such a remedy was neither specifically authorized by statute nor an equitable remedy administered by courts of equity at the time of the enactment of the Judiciary Act of 1789); *Clarke v. White*, 37 U.S. 178, 200 (1938) (at common law an insolvent debtor could prefer certain creditors over others).

B. Underlying Facts

International Thinklink Corporation ("Thinklink") was a messaging and communications company that offered its subscribers unified telephone and message services. (Pet. App. 24a). Lycos owns, operates and maintains a

network of computer websites grouped under its brand (the "Lycos Network"), from which it makes available a wide array of services and products to internet users. (Pet. App. 24a).

On December 21, 1999, Thinklink and Lycos entered into an E-Commerce Agreement (the "Original Agreement") pursuant to which the parties agreed: (i) to create a co-branded version of Thinklink's website (the "Thinklink Site") on the Lycos Network, and (ii) that Thinklink would have the exclusive right to provide certain defined message services on the Lycos Network for two years. (Pet. App. 24a to 25a). Among other things, under the Original Agreement, visitors to the Lycos Network could access the Thinklink Site and subscribe to Thinklink's services. (Pet. App. 25a). For its exclusive access to the Lycos Network, Thinklink agreed to pay integration fees totaling $20,000,000 over the two year term of the Original Agreement, to pay a portion of its net sales revenue, and to share any advertising revenue. (Pet. App. 25a).

Following Thinklink's payment defaults, Lycos and Thinklink renegotiated their agreement and, on or about December 23, 2000, Thinklink and Lycos executed an Amended and Restated Commerce Agreement ("Amended Agreement"). (Pet. App. 25a to 26a). Under the Amended Agreement, Thinklink's exclusivity period was shortened from two years to 90 days, and Thinklink's outstanding payment obligations were reduced from more than $17 million to $1 million plus preferred stock. On December 26, 2000, Thinklink made the $1,000,000 payment contemplated by the Amended Agreement (the "Challenged Transfer") but failed to deliver the stock. (Pet. App. 2a).

On February 14, 2001, Thinklink made a general assignment for the benefit of its creditors to Sherwood Partners, Inc., (the "Petitioner"), as assignee, who almost immediately shut down Thinklink's operations and began liquidating Thinklink's business. (Pet. App. 2a).

C. Litigation in the District Court

On May 18, 2001, the Petitioner commenced a lawsuit against Lycos to recover the Challenged Transfer pursuant to the provisions of Cal. Civ. Proc. Code § 1800 in the Superior Court of the State of California for the County of Los Angeles. (Pet. App. 26a). In its Complaint, the Petitioner did not allege that the Challenged Transfer did not satisfy a bona fide debt that Thinklink owed to Lycos, nor did Petitioner allege that the Challenged Transfer was made to hinder, delay or defraud creditors. Rather, the gravamen of the Petitioner's claim under Cal. Civ. Proc. Code § 1800 was merely that the Challenged Transfer enabled Lycos "to receive more than another creditor of the same class." (Pet. App. 26a).

Lycos removed the action to the United States District Court for the Central District of California (the "District Court") on the basis of diversity jurisdiction pursuant to 28 U.S.C. § 1441. (Pet. App. 2a, 47a). On July 23, 2001, Lycos moved to dismiss the Complaint on the ground that Cal. Civ. Proc. Code § 1800 was preempted by the enactment of the Bankruptcy Code, 11 U.S.C. § 101, *et seq*. On February 14, 2002, the District Court denied Lycos's motion to dismiss. (Pet. App. 48a, 63a). On January 17, 2003, the District Court entered judgment against Lycos. Lycos timely appealed.

D. The Court of Appeals' Decision

The Court of Appeals reversed the District Court's judgment and held that Cal. Civ. Proc. Code § 1800 is preempted by the federal Bankruptcy Code. *Sherwood*, 394 F.3d at 1206. (Pet. App. 13a). The Court began its analysis of the preemption issue with a recognition that while "there can be no doubt that federal bankruptcy law is pervasive and involves a federal interest so dominant as to preclude enforcement of state laws on the same subject . . . federal law [also] coexists peaceably with, and often expressly incorporates, state laws regulating the rights and obligations of debtors (or their assignees), and creditors" (internal quotation marks omitted). *Id.* at 1201. (Pet. App. 4a). The Court of Appeals, however, rejected Sherwood's claim that the preference avoidance provisions of § 1800 are not only tolerated by but in fact are incorporated into the Bankruptcy Code through § 544(b). *Id.* at 1201-06. (Pet. App. 5a to 13a).

The Court of Appeals drew a distinction between state law remedies available to any individual creditor and "special avoidance powers" vested exclusively in statutory representatives of creditors. Under the express language of § 544(b) of the Bankruptcy Code, a trustee in bankruptcy succeeds only to the causes of action available to a "creditor holding an unsecured claim" to set aside a debtor's transfers under "applicable [state] law." *Id.* at 1201-02 & n.2. (Pet. App. 5a to 7a). Relying on this Court's recent decision in *Hartford Underwriters Ins. Co. v. Union Planters, N.A.*, 530 U.S. 1 (2000), the Court of Appeals explained that reading the word "creditor" in § 544(b) so as to include "assignees" under § 1800 was flatly contrary to the express language of the Bankruptcy Code. *Sherwood*, 394 F.3d at 1202 & n.4. (Pet. App. 6a to 7a, 14a). The Court further

emphasized that the Bankruptcy Code expressly distinguishes between "creditors," defined, in relevant part, as "entit[ies] that ha[ve] a claim against the debtor," and the broader class of "custodians" that encompasses statutory representatives of creditors such as receivers, trustees and "assignee[s] under a general assignment for the benefit of creditors." *Id.* at 1202. (Pet. App. 6a to 7a). The Court of Appeals concluded that because "Congress did not mention custodians alongside creditors in section 544(b)," trustees in bankruptcy do not succeed to the rights of custodians under state law. *Id.* (Pet. App. 6a). State statutes such as § 1800 that vest statutory representatives of creditors, to the exclusion of individual unsecured creditors, with the power to set aside and recover transfers not otherwise subject to avoidance at common law, accordingly, are not incorporated into federal bankruptcy law by the provisions of § 544(b). *Id.* (Pet. App. 6a to 7a).

The Court of Appeals then addressed whether a statute that vests custodians with "new avoidance powers" unavailable to individual creditors, if not incorporated into the Bankruptcy Code, was "inconsistent with the enactment and operation of the federal bankruptcy system." *Id.* at 1202-06. (Pet. App. 6a to 13a). The Court of Appeals concluded that "statutes that give state assignees or trustees avoidance powers beyond those that may be exercised by individual creditors trench too close upon the exercise of the federal bankruptcy power." *Id.* at 1205-06. (Pet. App. 12a to 13a).

The Court's holding is premised on its recognition that, in a bankruptcy case, a trustee's exercise of the extraordinary power to avoid preferential transfers is subject to a host of procedural and substantive protections. *Id.* at 1204 & n.6. (Pet. App. 9a to 12a, 15a). Specifically, the Court of Appeals emphasized that this power may only be exercised under the

supervision of the federal courts; and the trustee exercising that power in a bankruptcy is not hand-picked by the debtor, but instead appointed and supervised by the United States Trustee (an official of the Department of Justice), or elected by the debtor's creditors. *Id.* at 1204. (Pet. App. 10a). The Court also stressed that federal bankruptcy law protects creditors from the trustee's possible conflicts of interest and possible self-dealing through a panoply of substantive and procedural provisions regulating, among other things, the trustee's employment of (and payment to) professionals to litigate such claims. *Id.* (Pet. App. 10a).

The Court of Appeals further reasoned that the commencement of state proceedings to recover transfers unassailable by individual creditors necessarily altered the incentives of creditors to seek federal bankruptcy relief and, as a practical matter, made it much more difficult for creditors, particularly out-of-state creditors, to avail themselves of the protections afforded by federal law. *Id.* at 1205. (Pet. App. 11a to 12a). Ultimately, the Court of Appeals determined that "Congress has thought carefully about how collective insolvency proceedings are to be conducted and set both substantive standards and elaborate procedural protections to ensure a result that is fair to debtors and creditors alike." *Id.* at 1205-06. (Pet. App. 13a). Accordingly, the Court of Appeals concluded that a California statute that vests unsupervised assignees, hand-picked by the debtor, with "special avoidance rights" not available to trustees in bankruptcy and that interferes with creditors' ability to avail themselves of the protections of federal law is preempted. *Id.* at 1202, 1205-06. (Pet. App. 7a, 12a to 13a).

REASONS FOR DENYING THE PETITION

I. THE COURT OF APPEALS' DECISION IS NOT A MATTER OF NATIONAL IMPORTANCE AS THE DECISION WILL HAVE MINIMAL IMPACT ON THE ADMINISTRATION OF BANKRUPTCY ESTATES AND OUT-OF-COURT LIQUIDATIONS ADMINISTERED UNDER STATE LAW.

A. The Court of Appeals' decision does not call into question the validity of assignments for the benefit of creditors and, on its face, has no application to individual creditor remedies or State laws governing the liquidation of corporate debtors.

The Petitioner's contention that the Court of Appeals' ruling can be read to preempt "general assignments" and "state laws that govern distribution to creditors" is without merit and cannot survive even a cursory review of the Court of Appeals' decision and its rationale. The sole issue addressed by the decision below is whether a state statute that vests unregulated assignees selected by the debtor with "new avoidance powers" not found at common law and unavailable to both individual creditors and the debtor alike is preempted by federal bankruptcy law. *Id.* at 1202, 1205-06. (Pet. App. 5a to 6a, 12a to 13a). The Court's ruling that a California statute that grants "state assignees entirely new powers that are not derived from contract and trust law" cannot fairly be read to invalidate an assignor's common law rights to convey property in trust or to specify how the proceeds of that property are to be distributed among beneficiaries. *See id.* at 1206 n.8. (Pet. App. 16a).

Indeed, so as to remove any doubt as to the scope of its holding, the Court of Appeals took pains to point out that it did not question the validity of common law assignments or of state law remedies available to individual unsecured creditors. *Id.* at 1204-05 & nn.6, 8. (Pet. App. 10a to 11a, 15a to 16a). Viewed in its proper context, therefore, the Court of Appeals' decision confirms that rights and powers that existed at common law do not conflict with the Bankruptcy Code or otherwise trespass on the field of bankruptcy, and leaves undisturbed a host of statutory provisions enacted in California (and elsewhere) to clarify and codify such common law rights. *See, e.g.*, Cal. Civ. Code § 22.2 ("The common law of England, so far as it is not repugnant to or inconsistent with the Constitution of the United States, or the Constitution or laws of this State, is the rule of decision in all the courts of this State."); Cal. Civ. Code § 1954.1 (recognizing the right of assignee to occupy business premises); Cal. Civ. Code § 3439.07(d) (authorizing assignee to exercise any rights and remedies available to individual creditors in connection with bringing a fraudulent transfer action); Cal. Civ. Proc. Code § 493.010 (defining a "general assignment for the benefit of creditors"); Cal. Civ. Proc. Code § 1802 (requiring that creditors receive notice of the assignment and the deadline for submission of claims to the assignee, and setting forth the assignor's obligation to provide the assignee with a list of creditors, shareholders and other parties in interest); Cal. Civ. Proc. Code § 1204 (providing for priority treatment of claims for wages, salaries, commissions, and employee benefit contributions); Cal. Civ. Proc. Code § 1204.5 (priority for consumer deposit claims).

B. Extra-judicial state law liquidations are not inherently less expensive or more equitable than liquidations effected through bankruptcy.

The Petitioner's claims that the decision below will (i) "leave debtors and creditors with no choice but to take insolvencies into bankruptcy," and (ii) "push corporations from the less stigmatic, less costly voluntary assignment scheme into the world of federal bankruptcy," have no basis in law or fact. (Petition for Writ of Certiorari ("Petition") at 7, 17).

First, as a threshold matter, the Petitioner has not proffered any evidence whatsoever that corporate liquidations through general assignments are less costly or more efficient than bankruptcy liquidations. In fact, the record in this case demonstrates that such non-bankruptcy liquidations can be (and often are) more expensive than liquidations effected through federal law because, among other things, an assignee's fees, unlike those of a trustee in bankruptcy, are not capped pursuant to § 326 of the Bankruptcy Code, and the fees and expenses an assignee and its professionals incur in winding down a corporation are not subject to judicial review and reduction pursuant to §§ 328 and 330 of the Bankruptcy Code. *See* 11 U.S.C. §§ 326(a), 328(a) & (c), 330(a) (2005).

For example, under the sliding scale established by § 326 of the Bankruptcy Code, a trustee's compensation is determined on the basis of all monies disbursed or turned over in the case to parties in interest, and is limited to: "25 percent on the first $5,000 or less, 10 percent on any amount in excess of $5,000, but not in excess of $50,000, and 5 percent on any amount in excess of $50,000, but not in

excess of $1,000,000, and reasonable compensation not to exceed 3 percent of such monies in excess of $1,000,000." 11 U.S.C. § 326(a). In this case, in contrast, the Petitioner was able to obtain a contractual fee of "the greater of (i) $75,000, or (ii) 7.5% of the total amount of funds generated from the sale of any liquidation of Assignor's assets, including all funds administered by Assignee." This likely translates into a considerably larger expense than would be incurred in a federal bankruptcy case.

For instance, if this estate were to distribute $500,000, the Petitioner's fee would be $75,000, while a trustee's fee under § 326 of the Bankruptcy Code would be only $28,250, yielding a cost difference of $46,750. For estates in excess of $1,000,000, this cost differential begins to grow dramatically: if the estate were to distribute $2,000,000, the difference expands to $66,750; if the estate distributes $5,000,000, the difference swells to $201,750; if the estate distributes $10,000,000, the difference grows to $426,750; and so on. *See id.* These numbers undermine completely any claim by Petitioner that unsupervised, out-of-court liquidations administered by an assignee are inherently cheaper than bankruptcy liquidations.

Furthermore, it appears that excessive compensation of this sort is not unusual in general assignments. *See, e.g,* Geoffrey L. Berman, *General Assignments For The Benefit Of Creditors, A Practical Guide* 5 (2000) (noting that assignee fees can be as much as 20% of the funds administered and disbursed but observing that "on average, [an assignee's] fees will range from five to ten percent of the proceeds generated"). Finally, in contrast with general assignments, the reasonableness of a bankruptcy trustee's fees and expenses and the fees and expenses of the trustee's

professionals is vigorously policed by creditors, the United States Trustee and ultimately the federal bankruptcy courts, further reducing the relative administrative cost of bankruptcy. *See, e.g.*, 11 U.S.C. § 330 (requiring bankruptcy courts to review the reasonableness of compensation sought in bankruptcy cases, and authorizing the court on its own motion, the motion of the United States Trustee or any other party in interest to award less compensation than requested); Stefan A. Riesenfeld, *Creditors' Remedies And Debtors' Protection* 453 (4th ed. 1987) ("Is there any reason for advising liquidation under state law other than the possibility of higher fees for the lawyers?").

Similarly, Petitioner's assertion that state law liquidations are less "stigmatic" than bankruptcy cases is both irrelevant and just plain wrong. Because a discharge is only available in bankruptcy and is unavailable to corporations that are liquidated under Chapters 7 or 11 of the Bankruptcy Code, the vast majority of assignments are by corporate debtors, rather than individuals, for whom a discharge is of paramount concern. And these corporate debtors simply dissolve after making assignments. Tabb, *The Law of Bankruptcy* § 1.5 at 28. There is, consequently, no entity left to which any supposed stigma could attach.

C. The substantial majority of States have no preference laws whatsoever.

More importantly, the Petitioner's prophesy that the Court of Appeals' decision sounds the death knell of state law general assignments is demonstrably false. After all, the substantial majority of states, 35 in total, do not have any preference recovery statutes on the books at all. Yet, even absent such preference recovery provisions, common law and

statutory assignments for the benefit of creditors remain viable alternatives to bankruptcy in each of these jurisdictions. *See generally*, Berman, *General Assignments For The Benefit Of Creditors, A Practical Guide* at 52-58 (compiling various state assignment statutes). And general assignees in these states apparently continue to liquidate corporations outside of bankruptcy without the assistance of statutes vesting them with "special avoidance powers" comparable to either Cal. Civ. Proc. Code § 1800 or § 547 of the Bankruptcy Code.

D. The Petitioner also misstates the impact of the Ninth Circuit's decision on those states in which the Petitioner alleges that preference statutes continue to be "on the books."

The Petitioner indulges in yet more hyperbole when it claims that the Court of Appeals' ruling is of "vital importance" because it "effectively call[s] into question the voluntary assignment laws of at least 15 other states that authorize an assignee to recover preferential transfers." *See* Petition at 8. This claim is flawed first because it is based on the mistaken assumption that the statutes it cites are equivalent to Cal. Civ. Proc. Code § 1800, and second because such so-called state preference statutes are apparently not widely and frequently used in state court proceedings to avoid and recover transfers that would otherwise be within the ambit of § 547. Specifically, in contrast with Cal. Civ. Proc. Code § 1800, at least five of the remaining 15 state statutes to which Petitioner cites, on their faces, empower individual unsecured creditors to recover potential transfers.[1]

1. In sharp contrast with Cal. Civ. Proc. Code § 1800, "any creditor" can bring claims under Ohio's and Kentucky's "preference" (Cont'd)

The decision below simply has no application to such statutes and the Court of Appeals could not have been any more explicit that its ruling applies only to "special avoidance rights" not available to individual unsecured creditors.[2] *See Sherwood*, 394 F.3d at 1205-06. (Pet. App. 12a to 13a). At most, therefore, the rationale of the Court of Appeals could only apply to statutes in ten other states.

Moreover, the Petitioner's unsupported claim that state preference statutes outside of California are widely and frequently used is belied by both case law and academic commentary. In contrast with the thousands of reported decisions involving the federal bankruptcy statute, there is scant federal or state authority applying and interpreting the state preference statutes cited in the Petition. While an

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(Cont'd)

statutes (Ky. Rev. Stat. Ann. § 379.060, and Ohio Rev. Code Ann. § 1313.58). Similarly, N.M. Stat. Ann. § 56-9-2 allows "any interested person" to sue to recover transfers made with the "design to prefer one or more creditors." Finally, the "preference" statutes on the books in Arizona and Texas facially authorize creditors to recover transfers that "give preference" if an assignee "neglects or refuses" to do so. *See* Ariz. Rev. Stat. § 44-1041; Tex. Bus. Com. Code § 23.09.

2. Petitioner's claim that the decision below would preempt the Uniform Commercial Code in "all 50 states" reveals a similarly flawed understanding of the Court of Appeals' holding and its rationale. Under Article 9 of the Uniform Commercial Code, an assignee is treated as a "lien creditor," that is as a creditor who has acquired a lien on the property assigned "by attachment, levy, or the like." *See* UCC § 9-102(52). Individual creditors, of course, are likewise able to obtain such liens through litigation. Accordingly, that state law chooses to treat a debtor's assignment of its property to an assignee as a lien in favor of the assignee simply does not implicate the decision in this case or its rationale.

electronic search of decisions citing to the federal preference statute, § 547 of the Bankruptcy Code, turns up more than 4,000 cases since 1978 (the year the Bankruptcy Code was enacted), there are only 42 reported federal cases during that same 27 year period that cite to state preference laws like Cal. Civ. Proc. Code § 1800, and 33 of those cases are from Kentucky and Ohio, where individual creditors can bring preference claims, as noted above. Similarly, for more than half of the state preferences statutes cited by the Petitioner, there has not been a single reported state court decision since 1978, and the remaining statutes gave rise to little more than a dozen reported state court cases in total over the past 27 years.[3] These numbers speak for themselves – state preference law is antiquated, vestigial, practically moribund and outside of California has been almost entirely displaced by federal bankruptcy law. Any notion that the decision of the Court of Appeals implicates a matter of "national importance" is, under these circumstances, a flight of fancy.

Finally, a review of the few reported decisions discussing those state statutes further undermines Petitioner's contention that state preference law is "a matter of national importance." *See, e.g., In re Roberds, Inc.*, 313 B.R. 732 (Bankr. S.D. Ohio 2004) (holding that Ohio's intent to prefer statute does not apply to the payment of a lawful debt in money, as opposed to the other forms of property); *Smith v. Cox*, 831 P.2d 981,

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3. Specifically, the "preference" statutes cited in the Petition in the following States have not been the subject of a single reported federal or state court decision since enactment of the Bankruptcy Code in 1978: Arizona; New Hampshire; New Mexico; South Carolina; South Dakota; Tennessee; and Texas. And the following states' "preference" statutes were cited in a total of just 13 reported state court decisions since 1978: Kentucky; Maryland; New Jersey; New York; North Carolina; and Ohio.

983 n.1 (N.M. 1992) ("[w]hile we recognize that . . . [New Mexico's anti-preference statute] specifically addresses questions of preferential transfers, we have omitted any discussion of this statute because the parties failed to raise it at any time"). Academic commentary likewise confirms that the state statutes cited to by the Petitioner are not part of the fabric of commercial law but instead are largely irrelevant outside of California. *See, e.g.*, Douglas C. Michael, *The Past and Future of Kentucky's Fraudulent Transfer and Preference Laws*, 86 Ky. L.J. 937, 958 (1994) (commenting that reported decisions show that "courts or counsel have apparently ignored or overlooked" the preference statute on the books in New Mexico); Thomas D. Buckley, *The Use of Ohio's Preference Law in Bankruptcy: An Alternative to Section 547 with a Longer "Reach Back" Period*, 20 Cap. U. L. Rev. 863, 865 (1991) (commenting that although the Ohio preference statute has a longer reach back period than § 547, and can be enforced by a non-preferred creditor in state court (and therefore a trustee in bankruptcy under § 544(b)), this potential advantage has been "generally overlooked" even though its "use could have made a difference in the outcome in some recent cases"). Put bluntly, in these circumstances, notwithstanding Petitioner's exaggerations to the contrary, the decision below simply does not give rise to a matter of "vital importance" that warrants this Court's time and attention.

II. THE DECISION BELOW DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT AND THERE IS NO SPLIT OF AUTHORITY ON THE NARROW ISSUE DECIDED BY THE NINTH CIRCUIT.

A. No other Circuit has even considered the narrow issue raised in this case, much less resolved that question inconsistently with the decision below.

Further evidencing that the narrow question decided below is not likely to recur, the Petitioner does not (and cannot) point to any split of authority on the issue among the Circuits or state courts in support of its request for certiorari. Confronted with this absence of any apparent conflict among modern courts, Petitioner instead attempts to conjure up a conflict "with the governing decisions of this Court." *See* Petition at 19. The Petitioner's claim, however, is flatly wrong. The simple truth is that this Court has never addressed the narrow issue raised in this case – whether the Bankruptcy Code preempts a state statute that vests assignees selected by the debtor with "special avoidance powers" unavailable to individual unsecured creditors and bankruptcy trustees. Nor is there any need for the Court to do so now. Each of this Court's prior cases cited in the Petition, which address the fundamentally distinct issue of the degree to which the states can regulate common law assignments and make remedies available to individual creditors, is readily reconciled with the Ninth Circuit's decision below. Equally important, the narrow issue raised in this case is not likely to recur for the simple reason that federal bankruptcy law has effectively replaced "state preference law" outside of California, even in those few states with such laws ostensibly "on the books."

B. The validity of so-called "state anti-preference statutes" was not raised, discussed or decided in either *Pobreslo* or *Star*.

Contrary to the Petition, neither *Pobreslo*, 287 U.S. 518, nor *Johnson v. Star*, 287 U.S. 527 (1933), "upholds" preference statutes. Neither case involved the recovery of preferential transfers from creditors by state law custodians. Just the opposite, both cases involved attempts by creditors of an assignor/debtor to reach property in the hands of an assignee for the benefit of creditors. And each case upheld assignments "which do not differ substantially from those arising under common law assignments for the benefit of creditors" and statutes which regulated "substantive rights" derived from contract and trust law. *Pobreslo*, 287 U.S. at 526; *see Star*, 287 U.S. at 528-30.

More importantly, although each case either quotes or extensively summarizes the provisions of the statute regulating the assignments under consideration by the Court (in fact, *Pobreslo* quotes the statutory provisions at issue in the case in full in the margin), neither case discusses, quotes from or otherwise references statutory provisions that empower custodians to recover preferences. Neither case, therefore, can be read as "upholding" such statutes. Indeed, it is impossible to determine from the four corners of *Pobreslo* or *Star* whether or not the state law at issue in either case empowered assignees to avoid preferential transfers. In short, therefore, Petitioner's characterization of these cases as upholding "state anti-preference statutes" when the validity of such statutes was not raised, discussed or decided, is inaccurate and misleading. *Cf. Webster v. Fall*, 266 U.S. 507, 511 (1925) ("Questions which merely lurk in the record, neither brought to the attention of the court nor ruled upon,

are not to be considered as having been so decided as to constitute precedents."). More importantly, *Pobreslo*'s and *Star*'s ratification of general assignments and state statute's regulating such assignments is fully consistent with the decision below, as the Court of Appeals expressly found that "federal law coexists peaceably with, and often expressly incorporates, state laws regulating the rights and obligations of debtors (or their assignees) and creditors." *See Sherwood*, 394 F.3d at 1201. (Pet. App. 4a).

C. The Petitioner's reliance on *Stellwagen* is misplaced.

Similarly, the Court of Appeals' decision is not at odds with this Court's decision in *Stellwagen v. Clum*, 245 U.S. 605 (1918). In *Stellwagen*, this Court ruled that "§ 6343 of the Revised Statutes of Ohio," which provided for, among other things, the avoidance of transfers by a debtor "in contemplation of insolvency and with a design to prefer one or more creditors to the exclusion of others," was not preempted by enactment of the Bankruptcy Act. 245 U.S. at 618. Ohio's Section 6343, however, is a singular statute and, as the Court of Appeals properly found below, is fundamentally different from Cal. Civ. Proc. Code § 1800 in not less than three material ways.

First, in contrast with Cal. Civ. Proc. Code § 1800, the Ohio law at issue in *Stellwagen* empowered creditors rather than custodians to commence civil actions to avoid transfers under § 6343. The importance of this difference to the Court's holding cannot be understated. Because "any creditor" rather than the debtor's hand-picked assignee could commence an action to recover property avoidable under § 6343, those same rights were available to bankruptcy trustees under the statutory precursor to § 544(b) of the Bankruptcy Code,

§ 70e of the Bankruptcy Act. Just like § 544(b), § 70e vested bankruptcy trustees with the rights of individual creditors – rather than custodians – under state law. *See* Vern Countryman, *The Use of State Law in Bankruptcy Cases (Part II)*, 47 N.Y.U. L. Rev. 631, 662-63 (1972) ("More troublesome is a state statute which can be invoked only by a 'receiver, trustee, common law assignee, or other liquidating officer of an insolvent corporation.' Here again, it does not seem proper to hold that this language includes a bankruptcy trustee. And, since it clearly does not include an individual creditor with a provable claim, the use of section 70e to invoke such a statute can be justified only by reading 'any creditor,' in section 70e to include any representative of any creditor. If that result is intended, it would be desirable to amend section 70e to say so.") (internal footnotes omitted). The fact that bankruptcy trustees could use § 6343 to recover property otherwise unavailable to bankruptcy estates was indispensable to this Court's determination in *Stellwagen* that the statute at issue was not preempted by the Bankruptcy Act. *Stellwagen*, 245 U.S. at 217, 219 (noting that in contrast with federal law, Ohio law had a four year rather than a four month reachback period for property avoidable under § 6343, and that the Court's holding that § 6343 is not preempted is expressly premised on "the provisions of section 70e"). In contrast, Cal. Civ. Proc. Code § 1800 vests custodians chosen by debtors with avoidance rights not available to other creditors and hence not available to bankruptcy trustees under § 544(b). In light of this fundamental distinction, *Stellwagen* cannot in any way be read as ratifying such a statute.

Second, the remedial provisions of § 6343 at issue in *Stellwagen* are materially different from Cal. Civ. Proc. Code § 1800. Under § 6344, upon obtaining a judgment declaring a transfer void, a creditor's remedy was the appointment of

a receiver to "take charge of all of the assets of such debtor or debtor's, including the property so . . . transferred," which receiver was required to administer these assets "for the equal benefit of creditors." That receiver, however, was appointed by a "court of competent jurisdiction" rather than a self-interested debtor and was required to be "duly qualified." *Stellwagen*, 245 U.S. at 609 n.1. Under Cal. Civ. Proc. Code § 1800, in contrast, the custodian who "administers" preference recoveries obtained involuntarily from out-of-state creditors like Lycos is not appointed or supervised by a state court and not required to be disinterested or otherwise "duly qualified" to administer impartially the proceeds of such litigation. *See Sherwood*, 394 F.3d at 1204. (Pet. App. 10a to 11a).

Although other provisions of § 6344 apparently vested "assignees," as well as creditors, with the right to commence lawsuits to avoid and recover transfers, in contrast with the case below, *Stellwagen* did not involve an assignment or an assignee's efforts to recover an alleged preferential transfer. Accordingly, the provisions of § 6344 empowering assignees to recover such transfers were not discussed, analyzed or approved by this Court in *Stellwagen*. Nor did they play any part in the Court's holding that bankruptcy trustees who succeeded to the rights of creditors rather than custodians under the Bankruptcy Act could use that state law to recover property otherwise unavailable to bankruptcy estates. At bottom, therefore, this Court in *Stellwagen* did not in any way endorse the unregulated, extra-judicial "administration" of preference recoveries from foreign creditors contemplated by Cal. Civ. Proc. Code § 1800.

Third, the peculiar statute at issue in *Stellwagen*, with its apparent focus on the debtor's and the transferee's state of mind, is more closely akin to fraudulent transfer law than to a modern preference statute such as § 547 of the Bankruptcy Code or Cal. Civ. Proc. Code § 1800. Facially, the so-called "preference provisions" of § 6343 focus on the parties' intent rather than the dividend available to similarly situated creditors. This distinction readily distinguishes § 6343 from modern preference statutes, where the inquiry is limited exclusively to the *pro rata* dividend available to creditors of the same class. *Cf.* H.R. Rep. No. 95-595, at 178 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6139 ("a creditor's state of mind has nothing whatsoever to do with [preference law's] policy of equality of distribution, and whether or not he knows of the debtor's insolvency does little to comfort other creditors similarly situated who will receive that much less from the debtor's estate as a result of the prebankruptcy transfer to the preferred creditor"); *Carruthers v. Kennedy*, 166 N.E. 801, 803 (Ohio 1929) ("A larger degree of moral turpitude is involved in a transaction with intent to hinder, delay and defraud creditors than is involved in a transaction with a design to prefer one or more creditors to the exclusion of others."); Douglas C. Michael, *The Past and Future of Kentucky's Fraudulent Transfer and Preference Laws*, 86 Ky. L.J. 937, 958 (1998) (recognizing that the parties' intent is a defining characteristic of fraudulent transfer law not preference law and noting that "[i]n Ohio, the confusion between fraudulent transfers and preferences has reached the statutory level"). Fraudulent transfer laws and modern preference laws are separate and fundamentally distinct bodies of law, and this Court's analysis of the antiquated fraudulent conveyance statute at issue in

Stellwagen sheds little light on whether or not state preference statutes are preempted by federal bankruptcy law.[4]

In sum, the decision below is by no means "in direct conflict" with *Stellwagen*. The Court of Appeals fully considered that case and properly concluded that Cal. Civ. Proc. Code § 1800 is a very different statute than the statute at issue in *Stellwagen* some 87 years ago.

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4. The Supreme Court has characterized the fundamental difference between a fraudulent transfer and a preference as follows:

> One is inherently and always vicious; the other innocent and valid, except when made in violation of the express provisions of a statute. One is *malum per se* and the other *malum prohibitum* – and then only to the extent that it is forbidden. A fraudulent conveyance is void regardless of its date; a preference is valid unless made within the prohibited period.

Van Iderstine v. National Discount Co., 227 U.S. 575, 582 (1913); *see also* 1 Garrard Glenn, *Fraudulent Conveyance and Preferences*, § 1 ("The preference materially differs from the fraudulent conveyance because it sins, not against the single creditor's right of realization, but only against the collective right of creditors as a class, that arises when their debtor becomes insolvent.") (rev. ed. 1940).

CONCLUSION

For the foregoing reasons, Lycos respectfully submits that the Petition should be denied.

Respectfully submitted,

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No. 04-1607

In The
Supreme Court of the United States

SHERWOOD PARTNERS, INC., Assignee for the Benefit of Creditors of International Thinklink Corporation,

Petitioner,

vs.

LYCOS, INC.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF *AMICI CURIAE*, RECEIVERS, INCORPORATED AND UECKER & ASSOCIATES, INC., IN SUPPORT OF PETITIONER

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MOTION FOR LEAVE TO FILE *AMICI CURIAE* BRIEF

Pursuant to Rule 37.2(b) of this Court, Receivers, Incorporated ("Receivers") and Uecker & Associates, Inc. ("Uecker") move for leave to appear as *amici curiae* and file the accompanying *Amici Curiae* Brief in support of Petitioner Sherwood Partners Inc.'s ("Sherwood") Petition for a Writ of Certiorari. Petitioner has consented to the filing of this brief; Respondent has not. Petitioner's letter of consent has been filed with the Clerk of the Court.

As explained in more detail in the Statement of Interest in the accompanying brief, Receivers and Uecker are private corporations that regularly act as fiduciaries with respect to insolvency matters. They are frequently appointed by courts as receivers, trustees or other fiduciaries and regularly accept assignments for the benefit of creditors for the purpose of liquidating the assets of an assigning debtor, administering the assignment trust estate and distributing assets to creditors as appropriate. As assignees for the benefit of creditors, they many times have sought the recovery of preferential transfers under California Code of Civil Procedure Section 1800 – which has been part of California's insolvency law for nearly thirty years and which the Ninth Circuit panel majority, over vigorous dissent, has now declared is in conflict with and pre-empted by the Bankruptcy Code. Accordingly, *amici* are directly impacted by the Ninth Circuit's decision. It impairs their ability to exercise rights that have been part of California's insolvency law for decades, adversely affecting their efficient and cost effective administration of assignment trust estates.

Because Receivers and Uecker regularly act as fiduciaries in a wide variety of contexts, they can provide the Court with a special perspective on the role assignments for benefit of creditors have historically played in California law.

This case presents significant issues concerning (1) the relationship of federal and state law in the insolvency area, (2) congressional intent in enacting significant parts of the Bankruptcy Code and (3) the authority of states to enact laws concerning insolvency issues that are designed and intended to provide debtors with more efficient and less costly alternatives to formal bankruptcy proceedings. Fifteen other states have insolvency laws the same as or similar to California's statute. Thus, the Ninth Circuit's pre-emption ruling has ramifications far beyond California's borders.

Receivers and Uecker therefore respectfully move for leave to appear as *amici curiae* and file the accompanying brief.

Respectfully submitted,

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AMICI CURIAE INTEREST AND AUTHORITY[1]

As described in the accompanying motion for leave to file, *amici curiae* are two privately-owned, California businesses that serve as fiduciaries in insolvency matters. They often have taken, and anticipate taking in the future, assignments for the benefit of creditors under California law. In fulfilling this role, *amici* have used, and desire to use in the future, the full range of rights and procedures available under California law to promote the efficient and cost-effective administration of assignment estates and to maximize the amount available for equitable distribution to all creditors.

The Ninth Circuit's decision in *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198 (9th Cir. 2005) – holding California Code of Civil Procedure Section 1800 pre-empted by the Bankruptcy Code – directly impacts *amici's* ability to administer assignment estates and to provide fully for the equitable treatment of all creditors. The panel majority's ruling is unprecedented and affects not only insolvency proceedings in California, but also in fifteen states that have insolvency laws similar to California's.

As a practical matter, the Ninth Circuit's decision eliminates state insolvency proceedings that have for decades been a more efficient and less costly alternative to formal bankruptcy proceedings. Moreover, it effectively jettisons these state law proceedings in the face of decisions by this Court upholding their validity and endorsing their utility. *Amici* therefore submit this brief urging the

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[1] Pursuant to Rule 37.6, *amici* affirm that no party or their counsel authored, or paid for, this brief in whole or in part.

Court to grant Petitioner Sherwood's Petition for a Writ of Certiorari.

INTRODUCTION

The Ninth Circuit panel majority (Judges Kozinski and Graber), over a lengthy dissent (Judge D. W. Nelson), held California Code of Civil Procedure Section 1800 is pre-empted by the Bankruptcy Code. *Sherwood*, 394 F.3d at 1206. This statute, which has been part of California's insolvency law for nearly thirty years, establishes a procedure by which assignees for the benefit of creditors can recover, for the benefit of all creditors, preferential transfers by debtors. Fifteen other states have statutes like or similar to California's. For decades, these state statutes have provided debtors, both individuals and businesses, more efficient and less costly state alternatives to formal federal bankruptcy proceedings.

In ruling that California's statute "trench[es] too close upon the exercise of the federal bankruptcy power," *Sherwood*, 394 F.3d at 1205, the Ninth Circuit's decision conflicts with three long-standing decisions of this Court upholding similar state statutes and endorsing state insolvency proceedings. *Pobreslo v. Joseph M. Boyd Co.*, 287 U.S. 518 (1933); *Johnson v. Star*, 287 U.S. 527 (1933); *Stellwagen v. Clum*, 245 U.S. 605 (1918). In attempting to distinguish these decisions, the panel majority did not read them closely enough and as a result identified distinctions of no consequence, as the dissent points out. *Sherwood*, 394 F.3d at 1207-8. In the insolvency law context, as in other technical areas of the law, detail matters. And overlooking detail can have profound ramifications, as this case illustrates, with the consequent

invalidation of a state law that, until the Ninth Circuit's decision here, had stood the test of time for more than a quarter century.

The panel majority's disdain for state insolvency procedures is unmistakable. It is also unfounded. And it is contrary to this Court's decisions consistently upholding laws providing for assignments for the benefit of creditors – indeed, upholding state laws providing the same procedures as California's law and which the panel majority now has condemned.

The panel majority also was seemingly oblivious to the anti-consumer bent of its decision. State insolvency laws, like California's assignment for the benefit of creditors statute, were designed and intended to provide an efficient, less costly alternative to formal federal bankruptcy proceedings. They have served that purpose well, and there is no justification for effectively eliminating this alternative, and burdening debtors, regardless of means, with the expense of formal bankruptcy proceedings. This only further depletes the debtor's assets to the detriment of creditors.

Accordingly, this case presents significant issues concerning (1) the relationship of federal and state law in the insolvency area, (2) congressional intent in enacting significant parts of the Bankruptcy Code and (3) the authority of states to enact laws concerning insolvency issues that are designed and intended to provide debtors with more efficient and less costly alternatives to formal bankruptcy proceedings. *Amici* urge the Court to grant Sherwood's petition for writ of *certiorari*.

ARGUMENT

I. THE NINTH CIRCUIT'S DECISION IS AT ODDS WITH THREE LONG-STANDING DECISIONS OF THIS COURT

In *Pobreslo*, 287 U.S. at 518, *Johnson*, 287 U.S. at 527, and *Stellwagen*, 245 U.S. at 605, this Court upheld the constitutionality of Wisconsin, Texas and Ohio insolvency statutes, respectively, all granting assignees for the benefit of creditors essentially the same preference recovery powers as California Code of Civil Procedure Section 1800. The Ninth Circuit's decision that Section 1800 is preempted by the Bankruptcy Code cannot be reconciled with these three decisions.

A. This Court's Decisions Upholding State Insolvency Statutes With Language Parallel To That Of California's Statute Are Controlling

There is no material difference between the powers granted assignees for benefit of creditors by the Wisconsin, Texas and Ohio statutes this Court has upheld, and the powers granted such assignees by California's Code of Civil Procedure Section 1800.

The Wisconsin statute at issue in *Pobreslo* provided:

> Whenever any insolvent debtor has made any conveyance or transfer of his property, with the intent to hinder, delay or defraud his creditors, or has made or suffered any conveyance, transfer or charge upon his property, which is void, by reason of being preferential or otherwise, and shall thereafter make a general assignment for the benefit of his creditors, it shall be lawful for such assignee or his successors to commence and

> prosecute to judgment any proper suit or suits to vacate such fraudulent conveyance, transfer or charge.

Vol. 1 Wisconsin Statutes Chapter 128, Section 128.05 (1929).

The Texas statute in *Johnson* provided in pertinent part:

> Except as to innocent purchasers for value, all property conveyed or transferred by the assignor previous to and in contemplation of assignment with the intent or design to defeat, delay or defraud creditors, or give preference to one creditor over another shall pass to the assignee by the assignment, notwithstanding such transfer; and the assignee, or in the case of his neglect or refusal, any creditor or creditors may in his name, upon securing such assignee against cost or liability, sue for, recover and collect the same, and cause the same to be applied for the benefit of creditors as other property belonging to the debtor's estate in the hands of the assignee.

Vol. 1 Revised Civil Statutes of the State of Texas, Title 12, Article 268 (1925).

The Ohio statute at issue in *Stellwagen* provided:

> Every sale, conveyance, transfer, mortgage or assignment, made in trust or otherwise by a debtor or debtors, and every judgment suffered by him or them against himself or themselves in contemplation of insolvency, and with a design to prefer one or more creditors to the exclusion in whole or in part of others, and every sale, conveyance, transfer, mortgage or assignment made, or judgment procured by him or them to be rendered, in any manner, with intent to hinder delay

> or defraud creditors, shall be declared void as to creditors of such debtor or debtors at the suit of any creditor or creditors as hereinafter provided, and shall operate as an assignment and transfer of all the property and effects of such debtor or debtors, and shall inure to the equal benefit of such creditor or creditors in proportion to the amount of their respective demands, including those which are unmatured.

Vol. 2 Annotated Revised Statutes of the State of Ohio, Section 6343 (1905).

Ohio law also went on to provide,

> . . . and any assignee as to whom any thing or act mentioned in the preceding section shall be void, shall likewise commence a suit in a court of competent jurisdiction to recover possession of all property so sold, conveyed, transferred, mortgaged or assigned, and shall administer the same for the equal benefit of all creditors as in other cases of assignments to trustees for the benefit of creditors.

Vol. 2 Annotated Revised Statutes of the State of Ohio, Section 6344 (1905).

While expressed in more modern language, California Code of Civil Procedure Section 1800(b) grants an assignee for the benefit of creditors essentially the same rights and powers granted assignees under the Wisconsin, Texas and Ohio statutes. California's statute contains a far more exact definition of what is and is not preferential, and of which transfers are recoverable and which are protected, for public policy reasons. The authority granted to assignees, however, is essentially the same. Thus, Section 1800(b) provides: